No. 12624

IN THE

United States Court of Appeals

FOR THE NINTH CIRCUIT

GEORGE T. GOGGIN, as Trustee of the Estate of Eugene C. Brisbane, Individually, and Brisbane & Company, a Limited Partnership, Bankrupts,

Appellant,

vs.

CONSOLIDATED LIQUIDATING CORPORATION and UNITED STATES OF AMERICA,

Appellees.

BRIEF FOR APPELLEE CONSOLIDATED LIQUIDATING CORPORATION.

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I.

Jurisdictional Statement.

The Appellee Consolidated Liquidating Corporation (hereinafter called "Consolidated") accepts the Jurisdictional Statement contained in Appellant's Opening Brief. (App. Op. Br. pp. 2-3.)

II.

Statement of the Case.

Appellant, trustee in bankruptcy of the Estate of Brisbane & Company, on March 31, 1948, obtained from Referee Hugh L. Dickson an order to show cause against Consolidated, praying that Consolidated pay to the Trustee any money owed to Brisbane & Company. [Tr. 17-18.]

The United States intervened, objecting to the summary jurisdiction of the Referee and urging that the

United States had lawfully appropriated the account in dispute in accordance with the provisions of the Anti-Kickback Act, P. L. 319, 79th Cong. 2nd Sess., 41 U. S. C. A. 51, 52. [Tr. 19-23.] The position of the United States on the merits was that such appropriation by the United States of the account upon which the Trustee was suing was a complete bar to the order to show cause. [Tr. 21-22.]

Consolidated and the United States appeared before the Referee through counsel upon the date set for hearing upon the order to show cause. Consolidated immediately offered the Referee a "Memorandum of Points and Authorities" [Tr. 23-31], acceptance of which was deferred by the Referee until shortly before the conclusion of the hearing. [Tr. 73-74.]

The Trustee called as his witness Mr. Robert M. Crawford, an accountant employed by Consolidated. Mr. Crawford testified that Consolidated's accounting records showed the sum of $20,390.82 accrued to Brisbane & Company upon open account [Tr. 75], and certain further sums, tentatively ascertained by preliminary audit but never approved for payment by appropriate governmental officials, as owing to Brisbane & Company on claims arising from termination of two subcontracts. [Tr. 76, 81-84.] Mr. Crawford testified that, in so far as he knew, the reason why "the money" (presumably the money accrued upon open account) had not been paid to Brisbane & Company was that Consolidated had been ordered not to pay it by two letters, which were introduced in evidence [Tr. 61-64], from the United States Maritime Commission and the United States General Accounting Office, respectively. Mr. Crawford also testified that his duties at Consolidated were concerned with accounting and that he

did not know whether Consolidated had any other reason for withholding any money from Brisbane & Company. [Tr. 85-86.]

After the conclusion of Mr. Crawford's testimony, the hearing became a rather informal discussion among counsel for Consolidated, counsel for the United States, counsel for the trustee, and the Referee. [Tr. 88-101.] Toward the conclusion of this discussion, counsel for Consolidated unsuccessfully sought permission to argue its defenses to the trustee's claim, these defenses being based upon alleged fraud and upon the orders of the United States Maritime Commission and the United States General Accounting Officer under the Anti-Kickback Act. [Tr. 101-102.] However, Consolidated was permitted to file and did file its "Memorandum of Points and Authorities" with the Referee. This "Memorandum of Points and Authorities" was in fact a document in which Consolidated objected to the summary jurisdiction of the Referee and set out both the facts and the law upon which it relied in refusing to recognize that it owed anything to the trustee or Brisbane & Company. The position taken by Consolidated in this Memorandum was as follows:

> (1) That Consolidated asserted substantial defenses to the trustee's claim; that, therefore, the trustee's claim could not be decided within the summary jurisdiction of the Referee, and that Consolidated demanded and was entitled to a plenary hearing [Tr. 30];
>
> (2) That any claim of Brisbane & Company against Consolidated had been extinguished by lawful action of the United States Government under the Anti-Kickback Act, 41 U. S. C. A. 51, 52 [Tr. 25];

(3) That such part of the trustee's claim against Consolidated as was asserted to arise under terminated subcontracts was unliquidated [Tr. 25-26]; and

(4) That Consolidated, under ordinary principles of the law of fraud, had a good defense to the trustee's claim and was entitled to a set-off in an amount sufficient to present a complete bar to the claims of the trustee, as successor to the assets of Brisbane & Company [Tr. 27-30].

Notwithstanding the above-mentioned objections by Consolidated, the Referee nearly one year later made findings of fact, conclusions of law and an order thereon to the effect that Consolidated owed the trustee $20,390.82 on an open book account and further sums of $1,370.72 and $4,722.75, "subject to the possible requirement of the United States Maritime Commission of further processing," and to the further effect that neither Consolidated nor the United States had "any substantial *bona fide* adverse claim in and to the said moneys" and that Consolidated should pay the sum of $26,484.29 to the trustee forthwith. [Tr. 47-50.]

Both Consolidated and the United States filed petitions for review of the order of the Referee, and the reviewing District Judge, the Honorable Peirson M. Hall, reversed the order. [Tr. 67-69.] The District Judge concluded that objections to the summary jurisdiction of the Referee were properly made and that both Consolidated and the United States had *bona fide* adverse claims which were "not spurious, colorable or frivolous" and that, therefore, both Consolidated and the United States were entitled to have their rights adjudicated in suits of ordinary character and not in summary proceedings. [Tr. 68-69.] As an additional ground for reversal, the District Judge

also decided that an unliquidated money claim could not be collected by the trustee in summary proceedings and that the claim in question was unliquidated because the party having actual possession contested it [Tr. 67], and because "of the provisions of the Termination of War Contracts Act (41 U. S. C. A. 101), under which final approval of the Maritime Commission of the amounts due Brisbane would have to be had before such claim could be considered as liquidated." [Tr. 68.]

III.

Summary of Argument.

A. A TRUSTEE MAY NOT ENFORCE A RESISTED MONEY CLAIM WITHIN THE SUMMARY JURISDICTION OF A COURT OF BANKRUPTCY.

B. A COURT OF BANKRUPTCY DOES NOT HAVE SUMMARY JURISDICTION TO RULE UPON A CLAIM TO PROPERTY PRESENTED BY A TRUSTEE AND DISPUTED BY A DEFENDANT IN POSSESSION, WHERE THE DISPUTE INVOLVES SUBSTANTIAL QUESTIONS OF EITHER FACT OR LAW. EVEN IF THE TRUSTEE'S MONEY CLAIM HEREIN WERE TREATED LIKE A DISPUTED CLAIM TO PROPERTY, IT COULD NOT BE ENFORCED WITHIN THE SUMMARY JURISDICTION OF THE REFEREE BECAUSE THE DISPUTE HEREIN INVOLVED SUBSTANTIAL QUESTIONS OF BOTH FACT AND LAW.

C. TIMELY OBJECTION WAS MADE TO THE SUMMARY JURISDICTION OF THE REFEREE HEREIN.

D. ON THE MERITS, CONSOLIDATED HAS A VALID DEFENSE BASED UPON THE ANTI-KICKBACK ACT.

E. EVEN IF THE RIGHT TO EXERCISE SUMMARY JURISDICTION HAD EXISTED, IT WOULD HAVE BEEN AN ABUSE OF DISCRETION ON THE PART OF THE REFEREE HEREIN NOT TO HAVE ORDERED THAT THE DISPUTE HEREIN BE DECIDED IN A PLENARY PROCEEDING.

IV.
ARGUMENT.

A. A Trustee May Not Enforce a Resisted Money Claim Within the Summary Jurisdiction of a Court of Bankruptcy.

Resisted money claims, as distinguished from claims to ownership of property, may not be enforced within the summary jurisdiction of a court of bankruptcy, regardless of whether or not the resistance is based upon merely colorable or upon substantial defenses.

In re Roman, 23 F. 2d 556 (C. C. A. 2d, 1928);

In re Eakin, 154 F. 2d 717 (C. C. A. 2, 1946);

Kelley v. Gill, 245 U. S. 116 (1917);

In re Italian Cook Oil Corporation, 91 Fed. Supp. 73 (D. C. N. J. 1950)).

The case of *In re Roman, supra,* 23 F. 2d 556 (C. C. A. 2, 1928), is precisely in point. The opinion was by Judge Learned Hand. Consolidated submits that the logic and authority of that opinion, too lengthy to set out here, compels affirmance of the decision of the District Judge below. No contrary authority has been found in the decisions of the United States Court of Appeals for the Ninth Circuit or in the decisions of the United States Supreme Court, and the case has never been criticized by any federal court. Further, the rule in the case of *In re Roman, supra,* is unqualifiedly reported as the law in the leading treatise on bankruptcy law. (*Collier on Bankruptcy,*

14th ed., Sec. 23.05, p. 481.) Moreover, the Supreme Court of the United States, in one of its most recent discussions of summary jurisdiction, citing the case of *In re Roman, supra,* has reaffirmed the principle that (although a trustee's claims to property may be enforced within the summary jurisdiction of a court of bankruptcy if adverse claims are merely colorable), a trustee may in no event enforce a mere chose in action within the summary jurisdiction of a court of bankruptcy.

> "Where Secs. 60(b), 67(e) and 70(e) were not involved, the Bardes rule continued to be applied where plenary proceedings were required, as in cases relating to property adversely held and suits upon choses in action belonging to the bankrupt's estate. [Citing *In re Roman, supa.*] Left for summary disposition under Sec. 2 were those proceedings in which the controversy related to property in the possession or constructive possession of the court or to property held by those asserting no truly adverse claim." (*Williams v. Austrian,* 331 U. S. 642, 651 (197).)

B. A Court of Bankruptcy Does Not Have Summary Jurisdiction to Rule Upon a Claim to Property Presented by a Trustee and Disputed by a Defendant in Possession, Where the Dispute Involves Substantial Questions of Either Fact or Law. Even if the Trustee's Money Claim Herein Were Treated Like a Disputed Claim to Property, It Could Not Be Enforced Within the Summary Jurisdiction of the Referee Because the Dispute Herein Involved Substantial Questions of Both Fact and Law.

Principles of law which would govern this appeal even if Consolidated's position as hereinabove set out were ignored are well established and have recently been succinctly stated by the United States Supreme Court:

> "A bankruptcy court has the power to adjudicate summarily rights and claims to property which is in the actual or constructive possession of the court. Thompson v. Magnolia Petroleum Co., 309 U. S. 478, 481, 84 L. Ed. 876, 879, 60 S. Ct. 628, 42 Am. Bankr. Rep. (N. S.) 216. If the property is not in the court's possession and a third person asserts a *bona fide* claim adverse to the receiver or trustee in bankruptcy, he has the right to have the merits of his claim adjudicated 'in suits of the ordinary character, with the rights and remedies incident thereto.' Galbraith v. Vallely, 256 U. S. 46, 50, 65 L. Ed. 823, 824, 41 S. Ct. 415, 46 Am. Bankr. Rep. 553; Taubel-Scott-Kitzmiller Co. v. Fox, 264 U. S. 426, 68 L. Ed. 770, 44 S. Ct. 396, 2 Am. Bankr. Rep. (N. S.) 912. But the mere assertion of an adverse claim does not oust a court of bankruptcy of its jurisdiction. Harrison v. Chamberlin, 271 U. S. 191, 194, 70 L. Ed. 897, 899, 46 S. Ct. 467, 7 Am. Bankr. Rep. (N. S.) 719. It has both the power and the duty to examine a claim adverse to the bankrupt estate

> to the extent of ascertaining whether the claim is ingenuous and substantial. Louisville Trust Co. v. Comingor, 184 U. S. 18, 25, 26, 46 L. Ed. 413, 416, 22 S. Ct. 293, 7 Am. Bankr. Rep. 421. Once it is established that the claim is not colorabe nor frivolous, the claimant has the right to have the merits of his claim passed on in a plenary suit and not summarily . . ." (*Cline v. Kaplan,* 323 U. S. 97, 98 (1944).)

An adverse claim by a third party in possession is colorable only "if on its face . . . made in bad faith and without any legal justification." On the other hand, an adverse claim is substantial, so as to deprive the bankruptcy court of summary jurisdiction

> "when the claimant's contention discloses a contested matter of right involving some fair doubt and reasonable room for controversy . . . in matters either of fact or law; and it is not to be held merely colorable unless the preliminary inquiry shows that it is so unsubstantial and obviously insufficient, either in fact or law, as to plainly be without color of merit, and a mere pretense." (*Harrison v. Chamberlin,* 271 U. S. 191, 194, 195 (1926).)

Appellant's Opening Brief conveys an erroneous impression when it cites cases for the proposition that

> "the bankruptcy court has the power to examine into claims in order to determine whether they are merely colorable or rest upon an untenable proposition of law." (App. Op. Br. p. 11.)

Even though a claim were to be eventually decided to rest solely upon an untenable proposition of law it could not be adversely determined within the summary jurisdiction of the bankruptcy court if the claimant's contention "disclosed some fair doubt and reasonable room for controversy . . ." as to the validity of such proposition of law. (*Harrison v. Chamberlin, supra,* 271 U. S. 191, 194, 195 (1926).) The cases cited by Appellant on page 11 of his Opening Brief do not purport to sustain any contrary proposition but merely involve claims concerning which it was, in fact, perfectly clear that no fair doubt and reasonable room for controversy existed on any matter of fact or law.

Applying the above-stated principles of law to this appeal it is evident that the Referee erred in deciding that the defenses raised by Consolidated to the claim of the trustee herein were not substantial and that the trustee could assert his claim in a summary proceeding, and it is likewise evident that the District Judge below was correct in reversing the Referee upon the ground that no summary jurisdiction existed.

Consolidated urged before the Referee the defense of fraud [Tr. 93, 101, 27-30], and the defense that the claim of the trustee had been appropriated by lawful action of the United States Government, leaving Consolidated not indebted to Brisbane & Company and leaving the trustee to assert his demands only against the United States [Tr. 101-102, 25-27]. The trustee, of course, would have the burden of proving that these defensive claims were only colorable in the sense that they were, on their face, made in bad faith and without legal justification and did not involve any fair doubt or reasonable room for con-

troversy. This follows because the trustee carries the burden of proof on contested jurisdictional issues.

Wuchner v. Goggin, 175 F. 2d 261 (C. C. A. 9, 1949);

City of Long Beach v. Metcalf, 103 F. 2d 483 (C. C. A. 9, 1939).

If the trustee could not prove such bad faith and absence of reasonable room for controversy on the part of Consolidated in urging the defenses, there would be no possible basis for summary jurisdiction. The record is absolutely barren of any evidence which could conceivably be sufficient to enable the trustee to carry this burden of proof and to sustain the summary jurisdiction of the Referee.

Consolidated's defense of fraud included the contention that Consolidated had a set-off defense in excess of the amount claimed because Brisbane & Company, in form a limited partnership in which Eugene Charles Brisbane was the sole general partner, had received excessive prices under its sub-contracts with Consolidated by virtue of Brisbane's collusion with Consolidated's purchasing agent, Mr. William McBurney. [Tr. 27-30.]

The record shows that Mr. Tobias Klinger, the Assistant United States Attorney who successfully prosecuted a criminal case against McBurney and Brisbane based upon a conspiracy to defraud the United States (which indirectly bore the burden of frauds practiced upon Consolidated because of the existence of cost-plus contracts between Consolidated and the United States), stated at the hearing before the Referee that the evidence in the criminal case showed that McBurney, who was Consolidated's purchasing agent, received large payments from Brisbane for ar-

ranging that Consolidated's orders be distributed to a group including Brisbane & Company under "fictitious and collusive bidding arrangements." [Tr. 89.] This statement may be hearsay if offered as proof of the matter asserted but it is weighty evidence on the jurisdictional question at issue, that is, whether Consolidated has reasonable grounds for believing that it has a set-off defense, based upon fraud, and is not urging such defense of fraud in frivolity and bad faith. Objections to the summary jurisdiction of a Referee are often necessarily and properly based upon affidavits or other similar hearsay matter which show that the defendant has reason to believe that he has a defense to the claim of the trustee.

The record also shows that the United States Maritime Commission has informed Consolidated that testimony in open court in the successful criminal prosecution of Brisbane and Consolidated's purchasing agent, McBurney, showed that McBurney "received through Brisbane a total of between $60,000 and $67,000 from the following subcontractors of Consolidated Steel Corporation named in the indictment:

Defendant	*Company*
Eugene Charles Brisbane	*Brisbane & Company"*

[Tr. 63.] (Emphasis added.)

In view of the above-mentioned indications in the record alone, it is evident that Consolidated has every reason to believe that Brisbane & Company over an extended period both participated in and benefited from a fraudulent and dishonest scheme whereunder Consolidated's purchasing agent was bribed to place orders, under collusive bidding arrangements, with Brisbane & Company and other subcontractors. Moreover, Consolidated has every reason to

believe that the very subcontracts upon which the trustee bases his claim were obtained from Consolidated by fraud and collusion on the part of Brisbane & Company. On the other hand, the only evidence presented by the trustee at the hearing before the Referee in his attempt to prove that Consolidated's fraud defense was only colorable was the fact that one of Consolidated's accountants did not know anything about a fraud defense, one way or another, because such matters were not handled in the accounting department. [Tr. 80, 86.]

Faced with this situation in the record, Appellant has sought in his Opening Brief to create the impression that a court of bankruptcy has summary jurisdiction to overturn any defense unless the party raising such defense to an order to show cause introduces elaborate evidence affirmatively showing that the defense is good on the merits. As has been hereinabove shown, the true rule is that an adverse claim, by its mere assertion, provides a contested jurisdictional issue and thus deprives the bankruptcy court of summary jurisdiction unless the trustee proves that the claim is made in bad faith and does not disclose a contested matter of right involving some fair doubt and reasonable room for controversy in matters either of fact or law.

Wuchner v. Goggin, supra, 175 F. 2d 261 (C. C. A. 9, 1949);

Harrison v. Chamberlin, supra, 271 U. S. 191, 194, 195 (1926).

Consolidated submits that the record shows that the trustee has not sustained any such burden of proof in connection with Consolidated's fraud defense and that, on the contrary, the record contains ample evidence that Con-

solidated has valid reason to believe that its fraud defense is sound and that, on this ground alone, Consolidated is not indebted to Brisbane & Company or its trustee in bankruptcy.

The Opening Brief of the Appellant seeks to sustain the Referee's implied finding that Consolidated's fraud defense was merely colorable in several ways.

First, Appellant states that Consolidated's accountant, Mr. Crawford, testified at the hearing before the Referee "that these letters constituted the only reason for the failure of Consolidated to pay the money owing to the bankrupt partnership; so far as Mr. Crawford knew, and he was in charge of the accounting department of the Shipbuilding Division of Consolidated, the money was owing and the amounts were correct. [Tr. 80-81.]" (App. Op. Br. p. 6.) Passing over the fact that, by reason of the introduction of a semicolon, Mr. Crawford's testimony gains something in this summation, it is clear that this appeal involves an order to pay over money to a trustee in bankruptcy issued after the hearing held on April 22, 1948, that at that hearing Consolidated's lawyers urged the defense of fraud, and that by no rational process of weighing evidence can it be determined that Consolidated's lawyers were thereby asserting a foolish and colorable defense merely because one of Consolidated's accountants testified as follows [quoting from the record]:

> "Q. (By Mr. Gendel): And as far as you know, those two letters and what is contained in the letters, are the reasons that Consolidated Steel Corporation have not paid the money, is that correct? A. (By Mr. Crawford): That is right." [Tr. 80.]

* * * * * * * *

"Mr. Klinger: May I clarify the record on that one point. Then it is not your testimony, is it, that the only reason the money has not been paid is the withholding order? You don't know if that is the only reason or whether there are additional reasons why this money has not been paid to Brisbane & Company?

The Witness: I only know that, as an employee, you might say, of Consolidated Steel, who would draw a check to Brisbane, I would say that in this particular instance I would not draw such a check in the face of these withhold orders. Whether there would be any other reason why they shouldn't be drawn, I wouldn't know. But that is sufficient for me not to pay." [Tr. 86.]

Second, Appellant complains concerning the United States General Accounting Office letter [Tr. 62] accusing Brisbane and Brisbane & Company of illegal and fraudulent conduct in obtaining orders from Consolidated, that "no where in the letter is there any showing of any amount that the bankrupt partnership, Brisbane & Company, ever paid to McBurney as an alleged kickback in return for receiving a contract with the United States Government or with Consolidated." (App. Op. Br. p. 9.) It cannot, of course, be seriously contended that when a businessman receives a formal letter from the United States Government stating that one of his buying agents has been receiving enormous bribes for distributing orders, through collusive bidding, among several suppliers, he should conclude that, since the Government has not informed him of the specific allocation, if any, of the bribe money among the various orders, he would be frivolous in assuming that he had a good defense by way of set-off and otherwise, based upon fraud, to claims under particular subcontracts

theretofore awarded to a particular accused supplier. Obviously, no particular significance should be attached to the absence of complete detail in the United States General Accounting Office letter.

Third, Appellant states that Consolidated has never contended that Brisbane & Company did not furnish labor and materials to Consolidated under the contracts in dispute, that the accounting records show money accrued to Brisbane & Company under such contracts, and that "It must be presumed, therefore, that the work was performed, the services and materials furnished, and that the ground, if any, for the refusal to pay the bankrupt partnership is based upon the alleged fraud of Eugene C. Brisbane, an individual." (App. Op. Br. p. 10.) There is, of course, no logical connection between the matters stated as facts by Appellant and the conclusion that Consolidated's refusal to pay is based upon "the alleged fraud of Eugene C. Brisbane, an individual," as distinguished from the fraud of Brisbane & Company, a limited partnership in which Eugene C. Brisbane was the only general partner. In fact, the very suggestion that Eugene C. Brisbane might corrupt Consolidated's purchasing agent with large bribes over an extended period for the benefit of other subcontractors and never obtain or seek to obtain, by the same corrupt means, any orders for Brisbane & Company is specious and unrealistic.

Fourth, Appellant states that "Consolidated has never made any adverse claim to these moneys. The sole reason for the failure to pay the same to the trustee herein are the letters from the Government agencies directing Consolidated not to pay." (App. Op. Br. p. 10.) This is an incorrect statement; Consolidated's position before the Referee was that it does not owe and refuses to pay any

moneys whatsoever to Brisbane & Company or its trustee in bankruptcy. [Tr. 23-30.] There is nothing in the record to indicate that Consolidated will pay anything to the trustee even if the Government withhold orders are cancelled. The only inference that legitimately might be drawn from the record is that if the withhold orders had never been issued, Brisbane & Company might possibly have obtained payment on all or part of its claims because, in the enormous rush of Consolidated's voluminous wartime business, the existence of the defense of fraud might not have been discovered in time to prevent payment to Brisbane & Company.

Consolidated does not rely solely upon the position that if it owed Brisbane & Company any moneys, the Government will not let Consolidated pay such moneys, but, on the contrary, regardless of the existence or non-existence of Government withhold orders, that it is not indebted to Brisbane & Company at all. As has been pointed out by Appellant "the United States [under its cost-plus contract with Consolidated] is in no way bound by any litigation between the trustee and Consolidated since the United States need not be a party thereto and would be permitted to make its own determination whether it would reimburse the prime contractor." (App. Op. Br. p. 17.) Consolidated dealt with Brisbane & Company as an independent contractor and is naturally concerned that it does not pay to Brisbane & Company any money that it does not owe.

Consolidated asserts the defense of fraud in this proceeding because it believes the defense to be well grounded and because it desires to protect its own funds from unjust claims. Any suggestion is erroneous which assumes that, but for the withhold orders, Consolidated would be

willing to pay these claims, relying upon the assumption that it would then be voluntarily reimbursed for the costs thereby incurred under its cost-plus Government contracts.

Consolidated's defense of fraud is substantial and not merely colorable. Consolidated was entitled to assert this defense at the hearing on the order to show cause which has culminated in this appeal. *Bankruptcy Act,* Section 68. Consolidated was entitled to litigate this defense in a plenary suit, under customary trial and pretrial procedures. On this ground alone the decision of the District Judge below should be affirmed.

Consolidated's defense based on the Anti-Kickback Act, 41 U. S. C. A. 51, 52, was likewise well taken. Consolidated has received formal written orders from the United States Maritime Commission and the United States General Accounting Office directing Consolidated not to pay the claim here in dispute. [Tr. 61-64.] Said written orders expressly purport to have been issued "pursuant to the specific provisions of said statute" [Tr. 61] and "In view of the Anti-Kickback Act . . . providing that the amount of such kickbacks shall be recoverable on behalf of the United States by set-off of moneys otherwise owing to the subcontractor by a prime contractor . . ." [Tr. 64.] If such orders are legally effective, they constitute, by their express terms, a complete bar to any recovery on the claim here in dispute against Consolidated by Brisbane & Company or its successor, the trustee in bankruptcy. In order to overcome the effect of these orders issued under the Anti-Kickback Act, Appellant argues, first, that it is "obvious from that statute . . . that its intent is to reduce the amount to be paid to a subcontractor or a prime contractor in an amount equal to the

reward paid by said subcontractor or prime contractor for the particular contract involved." (App. Op. Br. p. 12.) This argument is fallacious because the Anti-Kickback Act explicitly provides that forbidden kickbacks can be recovered by the Government "by set-off of moneys otherwise owing to the subcontractor either directly by the United States, or by a prime contractor under *any* cost-plus or fixed-fee or cost-reimbursable contract . . ." 41 U. S. C. A., Sec. 51.* (Emphasis added.) Appellant argues, second, that Brisbane & Company is not alleged to have violated the Anti-Kickback Act. (App. Op. Br. pp. 12, 14.) This argument is fallacious since it is clear that

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*The Anti-Kickback Act
(41 U. S. C. A., Secs. 51, 52.)

"Sec. 51. *Fees or Kick-backs by subcontractors on cost-plus-a-fixed-fee or cost reimbursable contracts: recovery by United States: conclusive presumptions: withholding of payments.*

"The payment of any fee, commission, or compensation of any kind or the granting of any gift or gratuity of any kind, either directly or indirectly, by or on behalf of a subcontractor, as defined in section 52 of this title, (1) to any officer, partner, employee, or agent of a prime contractor holding a contract entered into by any department, agency, or establishment of the United States for the furnishing of supplies, materials, equipment or services of any kind whatsoever, on a cost-plus-a-fixed-fee or other cost reimbursable basis; or to any such prime contractor or (2) to any officer, partner, employee, or agent of a higher tier subcontractor holding a subcontract under the prime contractor, or to any such subcontractor either as an inducement for the award of a subcontractor or order from the prime contractor or any subcontractor, or as an acknowledgment of a subcontract or order previously awarded, is hereby prohibited. The amount of any such fee, commission, or compensation or the cost or expense of any such gratuity or gift, whether heretofore or hereafter paid or incurred by the subcontractor, shall not be charged, either directly or indirectly, as a part of the contract price charged by the subcontractor to the prime contractor or higher tier subcontractor. The amount of any such fee, cost, or expense shall be recoverable on behalf of the United States from the subcontractor or the recipient thereof by set-off of moneys

the United States believes that Brisbane & Company has violated the Anti-Kickback Act. The first withhold order alleges payment of forbidden kickbacks by "Eugene Charles Brisbane, owner of Brisbane & Company," and directs a withhold against Brisbane & Company; the plain inference is that the Government believes that Brisbane & Company was intended to profit and did profit by such kickbacks and was therefore chargeable therewith under the Anti-Kickback Act. [Tr. 61-62.] In this connection it should be recalled that the Anti-Kickback Act forbids payment of kickbacks "either directly or indirectly by or *on behalf of* a subcontractor . . ." 41 U. S. C. A.,

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otherwise owing to the subcontractor either directly by the United States, or by a prime contractor under any cost-plus-a-fixed-fee or cost reimbursable contract, or by an action in an appropriate court of the United States. Upon a showing that a subcontractor paid fees, commissions, or compensation or granted gifts or gratuities to an officer, partner, employee, or agent of a prime contractor or of another higher tier subcontractor, in connection with the award of a subcontract or order thereunder, it shall be conclusively presumed that the cost of such expense was included in the price of the subcontract or order and ultimately borne by the United States. Upon the direction of the contracting department or agency or of the General Accounting Office, the prime contractor shall withhold from sums otherwise due a subcontractor any amount reported to have been found to have been paid by a subcontractor as a fee, commission, or compensation or as a gift or gratuity to an officer, partner, employee, or agent of the prime contractor or another higher tier subcontractor. Mar. 8, 1946, c. 80, Sec. 1, 60 Stat. 37.

"Sec. 52. *Same: definitions.*

"For the purpose of sections 51-54 of this title, the term 'subcontractor' is defined as any person, including a corporation, partnership, or business association of any kind, who holds an agreement or purchase order to perform all or any part of the work or to make or to furnish any article or service required for the performance of a cost-plus-a-fixed-fee or cost reimbursable contract or of a subcontract entered into thereunder, and the term 'person' shall include any subcontractor, corporation, association, trust, joint-stock company, partnership, or individual. Mar. 8, 1946, c. 80, Sec. 2, 60 Stat. 38."

Sec. 51. (Emphasis added.) The second withhold order very explicitly alleges that Brisbane & Company received orders from Consolidated in return for money paid to Consolidated's buying agent, McBurney. [Tr. 62-64.] Appellant argues, third, that the Anti-Kickback Act is unconstitutional unless construed to allow a Referee in bankruptcy to ascertain the validity, on the facts, of the set-off claim asserted by the United States Government. (App. Op. Br. pp. 14-16.) This argument is unsound since, even though constitutional pressures might conceivably force the implication that Brisbane & Company was entitled at some time to argue the factual correctness of the asserted basis for the Government's withhold order before some judicial forum, it is certainly unlikely that the statute would be construed to force the Government to defend its position in any forum where the prime contractor could be reached and before any attempt had been made to obtain an administrative remedy, and it would certainly be more logical to conclude that, after the Government exercises (on some factually erroneous basis) its right of set-off expressly given under the Anti-Kickback Act, the aggrieved subcontractor loses his claim against the prime contractor and retains only a claim against the United States to be asserted only after exhaustion of administrative remedies and only in the forums where claims against the United States or demands for relief against arbitrary administrative acts are usually tried. Moreover, even if the dubious legal propositions suggested by Appellant were sustained, the record does not in any way establish or prove that the claim of the

United States, which Consolidated recognizes as valid, is, on the facts, merely colorable in its contention that Brisbane & Company violated the Anti-Kickback Act and is thus properly deprived of its claim against Consolidated, if in fact Brisbane & Company would have a valid claim in the absence of withhold orders.

It is difficult to conceive of any claim whatsoever which can not be adjudicated, over protest, within the summary jurisdiction of the bankruptcy court if Consolidated's asserted defense based upon the Anti-Kickback Act can be determined to be only colorable in the sense that it does not invoke some fair doubt and reasonable room for controversy in matters either of law or fact. The District Judge below was correct in his conclusion that Consolidated's defense based upon the Anti-Kickback Act was "bona fide, and not spurious, colorable or frivolous" [Tr. 68], and that the Referee was therefore without summary jurisdiction to rule on the merits of such claim.

The cases cited by Appellant in his Opening Brief on pages 18-20 of his Brief are not authority for any contrary conclusion. The first three cases, *In re Capitaine* (D. C., Ed. N. Y., 1940), 31 Fed. Supp. 312; *In Matter of Goldman* (D. C., N. Y., 1833), 5 Fed. Supp. 973, and *Lahey v. Trachman* (C. C. A. 2, 1942), 130 F. 2d 748, 50 Am. B. R. (N. S.) 212, merely rule that property of which the bankrupt could have obtained possession on the date of bankruptcy can not be withheld from the trustee, because of the mere existence of demands made upon the party in possession by third persons after the date of bankruptcy, under circumstances where the party

in possession does not actively assert a beneficial interest in the property either for himself or for the third party. The theory is simply that, under such circumstances, between the bankrupt and the third party claimant, the bankrupt had constructive possession on the date of bankruptcy, and the rights of the party in possession are unaffected by the court's decision. The instant case is entirely different in that (1) the bankrupt could not have collected on any part of its claim against Consolidated on the date of bankruptcy and that, on the contrary, Consolidated then recognized the Government's superior rights in and to any claim which existed, and (2) Consolidated, alleging fraud on the part of Brisbane & Company, denies the very existence of any valid claim against it, owned by either the bankrupt or the United States, under the subcontracts in question.

In the fourth case cited by Appellant, *In re Engineers Oil Properties Corporation* (D. C., N. Y., 1947), 72 Fed. Supp. 989, no objection to the summary jurisdiction of the bankruptcy court was ever made and, furthermore, the court merely cited, as authority for its dictum, textbook law to the effect that when a trustee claims property in the possession of a party other than the bankrupt, such party must either claim that the property belongs to him or belongs to some other person, not the bankrupt. It is obviously not the law that any bankruptcy trustee is entitled upon demand to possession, for instance, of all the trust assets of Title Insurance and Trust Company of Los Angeles, and all the moneys owing from the Atchison Topeka & Santa Fe Railroad, merely because those

corporations do not claim the right to retain such assets and moneys solely for their own accounts. The text-book law means merely that in order to retain possession, it must be alleged by the possessor that the property claimed is held for another, not merely that the possessor believes that some party other than the bankrupt may possibly have some claim to the property.

Lastly, it is clear that part of the trustee's claim was unliquidated and therefore not within the summary jurisdiction of the Referee. The reversed findings of the Referee herein are to the effect that Consolidated owes the bankrupt the sum of $20,390.82 on open account and the sum of $6,093.47 "subject to the possible requirement of the United States Maritime Commission of further processing." [Tr. 49.] It is clear that the latter sum is the amount of a preliminary audit by Consolidated as to the amount it might be willing to pay an ordinary subcontractor, if the United States Maritime Commission approved, in settlement of unliquidated damage claims for termination of the subcontracts in question. Such preliminary audit does not fix the liability of Consolidated under the terminated subcontracts, any more than a preliminary estimate by Consolidated of the fair settlement value of a tort claim presented by an honest claimant would fix the amount owing to such claimant after suit was brought. The claim of Brisbane & Company under terminated subcontracts is clearly an unliquidated claim, by definition involving reasonable room for controversy, and, therefore, may not be ruled upon within the summary jurisdiction of a referee in bankruptcy.

C. Timely Objection Was Made to the Summary Jurisdiction of the Referee Herein.

Appellant does not directly argue that timely objection was not made to the summary jurisdiction of the Referee herein, but his Brief in its "Statement of the Case" contains a sentence to the effect that "The Judge was unable to find that Consolidated had ever objected to the summary jurisdiction of the bankruptcy court, since it had not done so." The record shows that at the hearing on the order to show cause, which has resulted in this appeal, Consolidated offered [Tr. 73] and delivered [Tr. 102] to the Referee herein a formal written document specifically stating that:

> "The matter is not within the summary jurisdiction of a referee in bankruptcy unless such jurisdiction is accepted by all of the parties thereto. The United States has earlier in these proceedings indicated that it will not waive its right to a plenary suit on these issues and Consolidated Steel Corporation has done likewise, and hereby reiterates its position." [Tr. 30.]

The hearing on the order to show cause was held on April 22, 1948, and the Referee's order, adverse to Consolidated, was not made until a year later, on April 12, 1949. [Tr. 36.] On this state of facts, Consolidated has certainly made a timely objection to the summary jurisdiction of the Referee within the established rule that an objection to the summary jurisdiction of a court of bankruptcy is timely if made at any time prior to entry of a final order with reference to the dispute in question.

Cline v. Kaplan, 323 U. S. 97 (1944).

D. On the Merits, Consolidated Has a Valid Defense Based Upon the Anti-Kickback Act.

The record in this case shows that the United States, acting under the Anti-Kickback Act, 41 U. S. C. A., Secs. 51, 52, prior to the date of bankruptcy herein purported to extinguish the account sued on by the trustee herein by setting off against it asserted liabilities to the United States arising under said Anti-Kickback Act. [Tr. 61-64.]

The Anti-Kickoff Act expressly provides for set-off of obligations to the United States arising under the Anti-Kickback Act against obligations owing to an allegedly guilty subcontractor from any prime contractor under a cost-plus contract with the United States. It provides that this right of set-off be exercised by notice to the prime contractor to withhold payments otherwise due the subcontractor, "in any amount reported to have been found to have been paid by a subcontractor" as a forbidden kickback. (41 U. S. C. A., Sec. 51.) The United States has very plainly indicated in its withhold orders that Brisbane & Company is properly chargeable with having paid forbidden kickbacks in an amount in excess of its claim against Consolidated, here in dispute, and has directed the withholding of the entire amount of such claim from Brisbane & Company. Under the Anti-Kickback Act it is required that Consolidated "shall withhold any amount *reported to have been paid* . . ." (41 U. S. C. A., Sec. 51.) The United States has reported that "Eugene Charles Brisbane, owner of Brisbane & Company, has paid more than $50,000.00 . . ." [Tr. 61.] The United States obviously considers, and by fair implication reports, that for purposes of the Anti-Kickback Act the amount reported to have been

paid was paid on behalf of and is properly chargeable to Brisbane & Company, against which the withhold order is directed. Therefore, if the Anti-Kickback Act is the law of the land, Consolidated *shall withhold* the amount here in dispute and Brisbane & Company shall not collect against Consolidated, regardless of whether or not the United States is in error in its report concerning forbidden kickbacks paid. The Anti-Kickback Act plainly contemplates that withhold orders utterly extinguish subcontractors' claims against prime contractors, leaving the subcontractor, if he feels aggrieved, to assert any grievance against the United States in the customary manner, by first exhausting his administrative remedy and then taking his case before the customary forums where claims against the United States or demands for relief against arbitrary administrative acts are tried. When Congress passed the Anti-Kickback Act, it can hardly be deemed to have considered that, in providing for set-offs in favor of the United States, it was requiring the United States to defend its asserted set-offs in any forum where the prime contractor might ordinarily be sued. This would be a radical departure from the established system of jurisdiction in cases where the United States is involved.

The Anti-Kickback Act by its express terms, upon the undisputed facts in the record of this case, has extinguished any claim of Brisbane & Company against Consolidated. Any adverse judgment on the merits of this case would necessarily have to be directed solely against the United States, for, as far as Consolidated is concerned, Congress has directed that it "shall withhold" the amount here in dispute from Brisbane & Company.

E. Even If the Right to Exercise Summary Jurisdiction Had Existed, It Would Have Been an Abuse of Discretion on the Part of the Referee Herein Not to Have Ordered That the Dispute Herein Be Decided in a Plenary Proceeding.

Even if, by some strange process, the Referee had acquired the right to decide the dispute herein in the exercise of his summary jurisdiction, it would have been an abuse of discretion on his part to enter the order which Appellant here seeks to reinstate after the short summary hearing transcribed in the record. [Tr. 73-102.] A Referee in bankruptcy has considerable discretion as to whether or not to order a plenary proceeding on matters which he has the right to decide in the exercise of his summary jurisdiction. It was apparent in the proceedings below that serious and complex questions of law and fact were presented in connection with the defense raised by Consolidated based upon the Anti-Kickback Act. It was even more apparent that Consolidated raised a defense based upon fraud to the claim of the trustee and that this defense, if controverted on the merits, would require the introduction of much evidence, from many witnesses, covering a series of transactions over an extended period. Under these circumstances, without allowing Consolidated to even argue its fraud defense and without reading the Memorandum offered by Consolidated, the Referee stated flatly that "I am going to make an order that you pay $20,390.82. You can take a review on that if you want to." [Tr. 102.] Consolidated submits that, even if the Referee had possessed summary jurisdiction to decide

the dispute herein, the decision reached on the record below should properly have been reversed by the District Judge, in the proper exercise of his discretion to correct an obvious injustice, with directions to the trustee to litigate his claim, if at all, in a plenary proceeding.

Conclusion.

Appellee Consolidated Liquidating Corporation respectfully prays that this Court affirm the order of the District Court below. In the event that the Court should decide that the Referee possessed summary jurisdiction to decide the dispute herein, it is respectfully requested that the decision of the Referee herein be reversed on the merits.

Dated this 3rd day of January, 1951.

Respectfully submitted,

WRIGHT & GARRETT,
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